Financial Markets

Irving Trust

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Economic Research &
Planning Division

Friday
(Noon)

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Fixed-income securities markets took encouragement this week from the continuing downward trend in the Federal funds rate, together with reports of August declines in industrial production and housing starts. Nevertheless, many market participants remain far from convinced that the lower funds rate is to be a permanent feature of the financial landscape. It will take still further declines--especially during October--to convince many skeptics that the rally of the last few weeks can be maintained.

Of course, if a pattern of pronounced economic weakness sets in, that surely can reduce credit demands and the demand for money, allowing interest rates to work lower. Though recent economic data definitely reflect a sluggish economy, the possibility of renewed expansion in the fourth quarter cannot be ruled out as yet, and many particpants clearly are taking a wait-and-see approach. Short-term business credit has expanded very rapidly during recent weeks, partially reflecting the disorder of the bond market. Strong business credit demands could be due either to a desire to expand operations or else to a need to finance undesired inventory accumulation. It is too early to say which of these influences has been more important. As far as money demand is concerned, it is clear for all to see that M-1B has been quite sluggish. Currently, the aggregate is more than $4 billion below our estimate of the Fed's short-run target. Nevertheless, a variety of essentially technical factors could lift M-1B around the beginning of October--whether they actually do so, of course, remains to be seen.

Chairman Volcker testified to the Senate Budget Committee this week, and several points in the testimony are worthy of note. He characterized money growth as being "reasonably on track" with respect to achieving the Fed's reduced money supply objectives, suggesting a continuing cautious approach. Interestingly, Volcker described the recent slowing of various inflation measures as "significant signs of progress"; in earlier statements this development had been viewed as tentative and possibly ephemeral. Finally, as he has done on many occasions in the past, the Chairman noted that, "For all the signs of progress today, we need to recognize that, in some respects, the toughest part of the job lies ahead." There can be no doubt as to the degree of commitment the Fed feels in pursuing its anti-inflationary course.

Near term, the current trading levels of the Federal funds rate appear quite sustainable--and there might even be some further drops. However, with the banking system needing a fairly substantial injection of reserves in the next several weeks, it is conceivable that a reluctant pattern of provision of reserves by the Fed could retard any tendency toward softness.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	9/18/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.00%	20.50%	12.50%
Effective since	9/15/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	10.00
Federal Funds	15.75	16.50	10.75
Repurchase Agreements	14.13	16.00	10.00
U.S. Treasury Issues			
Bills			
3 months	14.96	15.78	10.01
6 months	15.61	16.78	10.35
1 year	15.90	16.87	10.40
Coupons			
2 years	15.95	16.70	11.65
4 years	15.70	16.30	11.75
7 years	15.27	15.74	11.76
10 years	14.87	15.43	11.35
Long Bond	14.16	14.69	11.30
Negotiable Certificates of Deposit-Secondary Market			
1 month	16.15	17.15	11.00
3 months	16.40	17.45	11.10
6 months	16.75	17.75	11.60
1 year	16.65	17.80	11.70
Banker's Acceptances			
1 month	15.95	17.10	10.75
3 months	16.45	17.50	11.10
6 months	16.75	17.75	11.40
Eurodollar Deposits			
1 month	16.88	17.63	11.25
2 months	17.00	17.75	11.63
3 months	17.38	18.00	11.88
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	14.50	16.25	6.00
1 month	15.38	16.63	10.50
3 months	15.50	16.63	10.63
Bank Holding Companies			
1 month	15.50	16.50	10.63
Dealer Placed:			
3 months	15.50	16.85	10.88
New AA Corporate Utility Bond	17.15	17.75	13.13
Tax Exempt			
6 month Project Notes	9.15	9.90	5.50
1 year AAA Bond	9.00	9.30	5.90
5 year AAA Bond	9.50	9.80	6.10
20 year AAA Bond	12.65	13.10	8.00

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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